Ameritech has not performed such testing on the OSS interfaces developed for CLECs. Warren Mickens, Ameritech's Information Industry Svs. Vice President, has testified that AT&T, Ameritech's "largest retail customer," delivered only "200 orders per day" for the entire Ameritech region "for the first three weeks of April 1997." (MPSC Hearing, # U-11104, Transcript at 211-214 (May 28, 1997)). Thus, Ameritech has the capacity in place to process only 1,000 orders per day for AT&T. (Id. at 212).

In light of the above, Ameritech is simply wrong in asserting that its interfaces "provide[] . . . [CLECs] with equivalent access to information, elements, products and services that Ameritech provides to itself." (Br. at 22).[54] As noted by Ms. Reeves, the progress which Ameritech has made thus far appears disturbingly directed at convincing regulators in aid of Section 271 applications, not to try to bring about meaningful opportunities for local competitive entry.

D. Ameritech Should Be Required to Demonstrate How It will Bring Itself into Compliance with FCC Rules Requiring Full Number Portability Deployment in the Near Future.

Section 271 requires that the application for interLATA authorization demonstrate "full compliance" with the regulations issued by the FCC to require full number portability. The FCC has issued those regulations, and has specifically

54 As a consequence of Ameritech's OSS failures, CLECs, including Sprint, have had to rely on manual processes to interface with Ameritech. Sprint has recently learned, however, that Ameritech may be filing a tariff to limit the availability of manual processes. See Testimony of Warren Mickens, MPSC # U-11104, Transcript at 48-49 (May 28, 1997). If true, that would constitute a significant entry barrier to CLEC entry into Michigan. See Interconnection Order, 11 FCC Rcd at 15763, ¶ 516 (noting that BOC's OSS systems "and the information such systems maintain . . . represent a significant potential barrier to entry.").

ordered Ameritech to implement number portability in Detroit within the first five months of 1998 and in Grand Rapids by the Third Quarter of 1998.[55] Ameritech's expansive filing is noticeably silent on this point.

While Congress appeared willing to allow interim portability to suffice provided that the FCC had not yet ordered full number portability, plainly its goal was to ensure the timely deployment of real portability as soon as technically feasible. The FCC has now determined that full number portability is technically feasible, and that Ameritech is obligated to have it fully deployed in the Detroit and Grand Rapid MSAs within the next eleven to fifteen months. Because the necessary arrangements for full number portability will not be accomplished overnight, it can be reasonably expected that Ameritech would currently be deploying considerable resources to ensure that its regulatory obligations are met on time. However, Ameritech has not given the FCC or the public any assurance here that any of this is the case. The mere recitations that (1) it will begin to deploy full number portability in Michigan sometime before year's end[56] and (2) "[f]ull implementation in Detroit will be completed in the second quarter of 1998" (Mayer Aff. at ¶ 304) are not enough. Ameritech should be required to submit comprehensive reports demonstrating its on-target progress as a critical part of a credible application under Section 271. Moreover, under no conditions can a waiver of

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55 See Telephone Number Portability, *First Memorandum Opinion And Order On Recon.*, CC Docket No. 95-116, App. B (rel. March 11, 1997).

56 See Ameritech Brief at 52 ("Ameritech plans to begin implementation of long-term number portability in Michigan in the fourth quarter of 1997.")(emphasis added).

the time requirements be available to Ameritech Michigan.

IV. AMERITECH FAILS TO DEMONSTRATE THAT IT WILL COMPLY WITH THE SECTION 272 SEPARATE AFFILIATE SAFEGUARDS.

Section 271(d)(3)(B) requires the Commission to find that the application complies with the requirements promulgated under Section 272. That finding cannot be made on this record.

A. The Statute's Requirement for Distinct Officers and Directors Has Been Violated.

Ameritech has violated Section 272(b)(3)'s requirement that a BOC's long distance subsidiary's "officers, directors, and employees" be "separate" from those of the BOC because its long distance subsidiary, Ameritech Communications, Inc. ("ACI"), is ultimately managed by the same board of directors that controls Ameritech Michigan.

Ameritech Michigan claims that ACI's governance complies with the Section 272(b)(3) "separate board" requirement because it has no board of directors. (Br. at 57)[57] But neither ACI nor Ameritech Michigan -- nor any of the other Ameritech telephone operating companies -- has a board of directors. Thus, they all in fact share the same board of directors -- the board of Ameritech Corporation. Given this, there is no credible way in which to claim ACI's board is somehow "separate" from Ameritech Michigan's.

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[57] Pursuant to the terms of ACI's Certificate of Incorporation, the business of ACI is controlled by Ameritech Corporation, the sole shareholder of ACI, in place of a board of directors. In addition, Ameritech Corporation "may exercise all such powers of the corporation and do all such lawful acts and things as the corporation [ACI] might do." Section 7 of the Certificate of Incorporation of Ameritech Global Link, Inc. (June 28, 1994) (later renamed Ameritech Communications, Inc. (June 22, 1995)). See also Earley Aff. at ¶ 9.

While it is true that a corporation does not need a board of directors under Delaware law, the "separate board" requirement of Section 272(b)(3) represents Congress' determination that separation is necessary to ensure that the interLATA subsidiary is run independently of the BOC. Such independence is critical because directors are responsible for managing "the business and affairs" of a corporation and must do so under an "unyielding fiduciary duty to the corporation."[58] Moreover, directors have a duty to monitor the corporation in order to ensure that it is run according to the law,[59] as well as to make decisions based on the merits of the subject before the board and not on extraneous considerations or influences.[60] Indeed,

> Public policy . . . has established a rule that demands of a corporate officer or director, peremptorily and inexorably, the most scrupulous observance of his duty, not only affirmatively to protect the interests of the corporation committed to his charge, but also to refrain from doing anything that would work injury to the corporation, or to deprive it of profit or advantage which his skill and ability might properly bring to it, or enable it to make in the reasonable and lawful exercise of its powers.[61]

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58 See Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985).

59 See Francis v. United Jersey Bank, 432 A.2d 814 (N.J. 1981) (directors must make reasonable attempts to detect and prevent the illegal conduct of other officers and directors).

It is "the directors' duty to make necessary inquiries where suspicions are aroused or should be aroused;" however, "the duty of care does not require directors to ferret out lapses of [others] absent a warning or obvious red flag. See Dennis J. Block, et. al., The Business Judgment Rule - Fiduciary Duties of Corporate Directors 23 (4th ed. 1993)(citing cases)(quotations omitted). See also Graham v. Allis-Chalmers Mfg. Co., 188 A.2d 125, 127-130 (Del. 1963)(same).

60 See Dennis J. Block, et. al., The Business Judgment Rule - Fiduciary Duties of Corporate Directors 23 (4th ed. 1993).

61 Craig W. Palm & Mark A. Kearney, "A Primer on the Basics of Directors' Duties

In establishing a "separate board" requirement, Congress relied upon the duties of care and loyalty that directors owe their corporation as a means of enforcing BOC compliance with the separate subsidiary requirement and its concomitant bars against cross-subsidization and discrimination.[62] The "separate board" mandate is thus similar to the Commission's own requirements that recognize the importance of separateness to ensure that anticompetitive behavior would be curtailed. In adopting its Attribution rules which implement various cross-ownership restrictions, the Commission expressly acknowledged the control directors exert over corporations: "The Commission believes that it is both reasonable and necessary to take cognizance of the interests of directors [in applying its cross-ownership and multiple ownership rules] . . . in order to preserve competition and prevent monopoly in the broadcasting field." [63]

Because Ameritech Corporation's board manages both Ameritech Michigan and ACI, ACI lacks the kind of independent decision-makers Congress demanded.[64] Thus,

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in Delaware: The Rules of the Game," 40 Vill. L. Rev. 1297, 1302 n. 11 (1995) (citing Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939)).

62 As fiduciaries, directors must be loyal to both the corporation and its shareholders. See Van Gorkam, 488 A.2d at 872-73.

63 Amendment of Sections 3.35, etc., *Report and Order*, 18 FCC 288, 293 ¶ 13 (1953); Attribution of Ownership Interest, *Report and Order*, 97 FCC 2d 997, 1025 ¶¶ 58-59 (1984) (permitting directors of parent corporations of licensees to assert non-cognizable status if his/her duties are not directly or indirectly related to the activities of the broadcast licensee).

64 See Dennis J. Block, et. al., The Business Judgment Rule - Fiduciary Duties of Corporate Directors 23 (4th ed. 1993)("A director is not independent where he is dominated or otherwise controlled or beholden to . . . an entity interested in the conduct or transaction at issue.").

ACI does not satisfy the "separate board, officer and employee" requirement in Section 272(b)(3).

B. Ameritech's Plans Reveal Improper Leveraging of its Local Exchange Monopoly into the InterLATA Market.

Ameritech Michigan's application discloses plans to impermissibly extend its local monopoly into long distance services. Specifically, Ameritech appears to have tried to draw a large loophole in its non-discrimination obligations when new local telephone subscribers (including subscribers switching locations) contact Ameritech Michigan to subscribe to (or change) their local service.

Absent adequate safeguards, Ameritech Michigan's local exchange service monopoly provides it substantial opportunities to favor ACI by recommending ACI's services to local subscribers or otherwise omitting reference to the available options for long distance providers. In recognition of this potential, the Commission requires BOCs to "provide any customer who orders new local exchange service with the names and, if requested, the telephone numbers of all of the carriers offering interexchange services in its service area."[65] While the provision of IXC telephone numbers need only occur upon customer request, the provision of the names of all IXCs is mandatory in all cases. Ameritech fails to comply with this crucial requirement. Its script for inbound marketing allows the Ameritech Michigan representative to avoid listing competing IXCs

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[65] Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended, *First Report and Order and Further Notice of Proposed Rulemaking*, 5 Comm. Reg. (P&F) 696, 783-84 ¶ 292 (1996)("Non-Accounting Safeguards Order").

and, indeed, to specifically steer customers to ACI.[66] Moreover, nothing in the instructions to the representatives allows for the provision of IXC telephone numbers to the customer upon request.[67]

Ameritech Michigan's attempt to leverage its local monopoly power into the long distance market is not an isolated incident. Ameritech Michigan recently exhibited similar tendencies just a month before the implementation of intraLATA toll dialing parity in a significant percentage of its region. At that time, Ameritech Michigan conducted a deceptively labeled "anti-slamming" campaign in which local exchange customers could return a form in their bill which, in effect, froze Ameritech as their presubscribed intraLATA toll carrier, absent direct written or oral authorization from the customer. The Michigan Public Service Commission ("Michigan PSC") found Ameritech's PIC freeze bill insert to be " misleading and deceptive."[68] The MPSC concluded that the effect of the program was "anticompetitive" because the insert was

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66 The script states: "You have a choice of companies, including Ameritech Long Distance, for long distance service. Would you like me to read from a list of other available long distance companies or do you know which company you would like?" The representative is instructed to process the order if the customer chooses a company, without providing the names of the other carriers offering interexchange services in the area. See Early Aff. at Schedule 7.

67 ACI will reimburse Ameritech Michigan for the time spent by the Ameritech Michigan service representative for mentioning Ameritech Long Distance and its services. See Early Aff. at ¶ 46. Of course, were ACI allowed this advantage, its value would far exceed the nominal costs as it captures the full benefit of the local monopoly.

68 Sprint Communications Company L.P. against Ameritech Michigan, Case No. U-11038, *Opinion and Order* at 5 & 8 (Mich. PSC, Aug. 1, 1996).

mailed "just before intraLATA dialing parity was offered."[69] Ameritech's resistance to intraLATA dialing parity foreshadows its likely response to local competition and to its entry into interLATA services.

Ameritech has also exhibited what can best be described as indifference to the Section 271 interLATA proscription itself. Responding to an investigative letter from the Chief of the Common Carrier Bureau, apparently prompted by the Ameritech CEO's rather remarkable public complaint of having been "slammed" away from his own company as his PIC, Ameritech has weakly defended its "Friendly User Trial" activity as alternatively official service or a "give-away" not covered by Section 271.[70] Ameritech's facially erroneous construction of Section 271 is troubling most especially here because it reflects a propensity on its part to "shoot first and ask questions later" anytime it confronts what it regards as legal uncertainty.

Again, Ameritech Michigan's application promises compliance with the joint marketing rules under Section 272,[71] while its actions raise anticompetitive concerns. On May 23, 1997, the Michigan Cable Television Association filed a complaint with the Michigan PSC urging it to investigate potential cross-subsidization abuses in Ameritech's "AmeriCheck" marketing program.[72] The complaint states that customers

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69 Id. at 11-13.

70 See Letter from Lynn Starr, Executive Director, Federal Relations at Ameritech to Regina Keeney, Chief, Common Carrier Bureau, Federal Communications Commission (April 21, 1997).

71 See Earley Aff. at ¶¶ 42-48.

72 The Complaint of the Michigan Cable Television Association, et al., against

may earn AmeriChecks for taking cable service from the Ameritech cable affiliate and that such vouchers may be used to pay for a variety of Ameritech services, including local telephone service. The complaint requests the Michigan PSC to ensure that Ameritech's telephone customers are not being "forced to subsidize Ameritech's efforts to offer cable television in a few Detroit suburbs."[73] The Michigan PSC has not had the opportunity to investigate this matter. However, the allegations are serious enough and sufficiently supported to raise concerns and prompt official inquiry. If "joint marketing practices" induce subscription to the competitive service by offering discounts on the regulated monopoly service, the "joint marketing" may constitute cross-subsidization and cannot be tolerated under the Act.

The Commission's Section 271 process should not operate as a blind self-certification procedure. Ameritech Michigan's past and ongoing behavior strongly suggests violations of the statute and the Commission's rules, yielding one more basis for denying its Section 271 application.[74]

Ameritech Michigan for Violation of the Michigan Telecommunications Act and an Application for Investigation Under the Michigan Telecommunications Act and the Michigan Consumer Protection Act, Case No. U-11412, *Complaint and Application for Investigation* (Mich. PSC, May 23, 1997).

73 Id. at 10.

74 This is particularly disturbing because these practices have occurred prior to Ameritech Michigan's receipt of in-region interLATA authority. As Marius Schwartz stated in his affidavit attached to the Evaluation of the Department of Justice of SBC's Section 271 application, "once [in-region interLATA] entry is authorized, BOC incentives to continue cooperating will diminish significantly." See Schwartz Aff. at 54, attached to DOJ Evaluation. In light of Ameritech Michigan's history of disregard for the principles contained in Section 272, the Commission must consider the effect on competitive growth from Ameritech Michigan's inevitably diminished incentives to comply with Section 272's

V. THE APPLICATION IS INCONSISTENT WITH THE PUBLIC INTEREST.

Congress determined that no BOC should be allowed entry into the interLATA market within its region until it has relinquished its monopoly stranglehold over the local exchange markets on a state-by-state basis. Since this has not been done in Michigan, it would violate the public interest to permit Ameritech in-region, interLATA relief in that State.

A. Ameritech Has Not Shown That Competition Is Enabled In Michigan.

Ameritech's weak effort to the contrary, the record reveals that the local exchange markets in Michigan have not been opened to competition, or even the potential for competition. There is only a minute amount of competitive activity present in one or two local areas.

As described in the attached affidavit of Professor Carl Shapiro, the "best proof of the feasibility of local exchange competition is the actual presence of facilities-based local competitors" and "the more widespread is local competition, the more it takes place over facilities outside the control of the ILEC, and the greater number of actual CLECs, the more confident we can be that conditions are truly conducive to entry."[75] This view squares fully with the Justice Department's position that markets must be "irreversibly open" to competition in order to ensure that BOC entry will serve the public interest.[76]

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separate affiliate safeguards after grant of Section 271 authority.

75 See Shapiro Aff. at 10.

76 See DOJ Evaluation at 44 (citing Schwartz Aff. at ¶¶ 19, 149-169).

The record shows plainly that competition is at most inchoate in Michigan. As noted by the MPSC, Ameritech serves 4.97 million access lines as compared to the 15,000-20,000 for all Michigan CLECs.[77] Indeed, the tiny amount of loops, numbers ported, white pages listings, ordered or provisioned from Ameritech in Michigan is aptly demonstrated by Ameritech's own affiant, Theodore A. Edwards. Taken together, MCI, Brooks, MFS, and TCG have but six switches in four cities[78] in contrast to Ameritech's more than 440 switches throughout the State.[79] Further, as of April 30, 1997, those four firms had virtual collocation arrangements in no more than 37 of Ameritech's 336 Michigan wire centers.[80] Even with Ameritech's optimistic predictions, as of July 1997, CLECs are expected to be collocated in offices that serve only 42% of Ameritech's business access lines and 29% of its residence access lines.[81]

Moreover, there appears to be at best only one small competitive provider actually providing <u>any</u> residential service over its own facilities, Brooks Fiber. Although Ameritech has told the MPSC that Brooks "is currently providing service to a substantial

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[77] MPSC Comments, CC Docket No. 97-1 at 14 (Feb. 5, 1997)(Vol. 4.1, Part 8).

[78] <u>See</u> Harris/Teece Aff. at 47, Table III.6.

[79] <u>See</u> Ameritech Michigan's Submission of Information, MPSC Case # U-11104, *Exhibit 7b* (Nov. 12, 1996)(Vol. 4.1, Part 3)(setting forth information on each of Ameritech's switches).

[80] <u>See</u> Harris/Teece Aff. at 33(noting that in Michigan the total number of collocated offices for all carriers was 37 as of April 30, 1997). Ameritech Michigan's Submission of Information, MPSC Case # U-11104, *Response to Question 5* at p.15 (Nov. 12, 1996)(denoting # of Ameritech wire centers).

[81] <u>See</u> Harris/Teece Aff. at 33.

number of residential customers,"[82] the reality is that Brooks served only 3,600 residential customers at that time and all were located in Grand Rapids.[83] While Brooks has since gained a few more residential subscribers,[84] ninety percent of its residential customers are served via unbundled loops obtained from Ameritech.[85] Michigan has a population of over 9.5 million people[86] spread out over 680 townships and cities.[87] Consequently, Ameritech's power in the local exchange (and its corresponding power to harm competition in the long distance market) is not at all curbed by Brooks Fiber's service to a few thousand residential customers in Grand Rapids over Ameritech's unbundled loops.[88] Stated otherwise, Brooks Fiber's residential service is used by only 0.061% of (or 1 of every 1,636) Michigan residents.

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82 See Ameritech Reply to MFS, MPSC #U-11104 at 5 (Jan. 31, 1997)(Vol 4.1, Part 7).

83 See MPSC Comments, CC Docket No. 97-1 at 14 (Feb. 5, 1997)(Vol. 4.1, Part 8).

84 Brooks recently stated that it has 5,805 residential lines in service in Grand Rapids. See Brooks Fiber Quarterly Report at 3 (April 28, 1997), attached to Ameritech Information Submission, MPSC U-11104 (May 9, 1997)(Vol. 4.1, Part 14).

85 See Brooks Fiber Mot. To Reopen, MPSC #U-11104 at 8 (March 7, 1997)(Vol. 4.1, Part 9).

86 See 1997 Information Please Almanac 763 (Otto Johnson, ed., 1997).

87 See County and City Data Book 883-887 (Dept. Of Commerce, Aug. 1994 ed.).

88 In its most recent Quarterly Report, Brooks stated that it has 5,805 residential lines and 14,492 business lines in service in Grand Rapids. See Brooks Fiber Quarterly Report at 3 (April 28, 1997), attached to Ameritech Information Submission MPSC U-11104 (May 9, 1997)(Vol. 4.1, Part 14).

As explained by Dr. Shapiro, significantly more commitment must be observable to ensure that entry barriers have in fact been lowered and competition has been enabled. This requires observable sunk investment by CLECs -- something lacking here. Sprint has already set forth the basis for its belief that the ownership of independently constructed and operated facilities is a statutory prerequisite to grant of a Section 271 application under Track A.[89] But even if the FCC proceeds to find that the terms of Track A are satisfied by the mere leasing of UNEs, certainly the presence of independent construction and operation of competitive facilities representing sunk investment is required for the public interest test to be satisfied.

The public interest test requires the demonstration of sunk investment by CLECs to reflect investment in and commitment to market entry and expansion.[90] The leasing of some loops cannot establish the presence of sunk costs; indeed, while CLECs must in some cases pay nonrecurring charges for UNEs, Ameritech's arrangements for UNEs generally permit the CLEC to terminate the lease at any time.[91] Thus, an

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89 Moreover, the statute requires that these competitive facilities be either the "exclusive[]" or "predominant[]" source of capacity for the CLECs' provision of competitive services. Further, as Sprint has briefed in full elsewhere, see Sprint Pet. to Deny in CC Docket 97-121 at 3-15, this requirement attends separately to each business and residential classes of subscribers. These requirements flow as a matter of law and policy.

90 See Shapiro Aff. at 11. The Justice Department has reached a similar conclusion. See Schwartz Aff. at ¶ 174, attached to DOJ Evaluation.

91 Local loops represent the most competitively significant plant. Local loop investment is by far the most financially significant investment, simply as a matter of dollars expended. But it also means true sunk costs, and thus a real commitment by a competitor to market entry and growth. The loop also represents the most significant source of the incumbent LEC's bottleneck

of reselling Ameritech services in the Grand Rapids area.[95] Likewise, Sprint's near-term business plans do not go beyond resale.[96] All CLECs, then, are unambiguously dependent upon Ameritech Michigan's local monopoly at this time. This cannot be what Congress considered acceptable in setting out a qualitative test for facilities-based local competition.

B. The Commission Must Assess the Likelihood of Near-Term Entry in Other Parts of the State.

It is plain that Congress did not intend to allow BOC interLATA entry upon the mere showing of highly localized, insignificant entry. As already discussed, the paltry amount of CLEC activity to which Ameritech can point is insufficient, both as a matter of showing that the markets have truly been opened under Track A, or the public interest determination of 271(C). The FCC has the obligation under the public interest provision to consider the scope and significance of that entry to the state as a whole.

While Congress chose not to require the establishment of local competition in every part of the State as a Section 271 prerequisite for BOC authorization, it is nevertheless necessary and appropriate to the Commission's public interest assessment to consider and evaluate the other markets throughout the State. The FCC must be able to assure itself that local competition is sufficiently enabled throughout the

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95 See Harris/Teece Aff. at 73 & 80-81. See also Jim Harger, *AT&T Enters Local Phone Market*, The Grand Rapids Press, March 11, 1997, at A1 (noting that AT&T's Michigan operations are limited to reselling Ameritech's services in Grand Rapids and that AT&T will move "very slowly" to expand to other areas.).

96 That MCI also has made only a minimal investment is demonstrated by Ameritech's estimates that MCI has one switch and 60 route miles of fiber in Michigan. See Harris/Teece Aff. at 47.

State so that neither ratepayers nor competitors can be harmed on a regionalized basis. The presence of local competition in numerous commercial and residential centers in a state also strongly suggests its irreversibility.[97]

In assessing the adequacy of interconnection arrangements, the FCC thus needs to consider not only the presence of competitors in Grand Rapids, but other, far more significant areas of commerce and population. Brooks Fiber, the only CLEC claimed by Ameritech to be carrying any amount of non-resale commercial and residential local exchange traffic, has only three switches in the entire State and provides no service in Detroit whatsoever. The competitive arrangements in Grand Rapids relied upon by Ameritech must necessarily be available, replicable, and workable not only in Grand Rapids but also in all other parts of the State.[98] As the House Report explained the section in the House bill that evolved into Section 271(c)(1)(A):[99]

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97 Ameritech does not disagree, stating that "[t]he best argument for the importance of entry conditions in disciplining the telecommunications market is the actual evidence that it works." See Gilbert and Panzar Aff. at ¶ 71.

98 Ameritech's evidence of other CLEC activity seems to be predicated largely on Ameritech's own estimates and the fact that the CLEC has a tariff on file. For example, Ameritech has stated that Detroit customers have a choice of local providers because "MCI Metro has [] tariffs on file for its service territories in 20 exchanges in the metropolitan Detroit area." See Ameritech Information Submission, MPSC #U-11104 at 3 (May 9, 1997)(Vol. 4.1, Part 14). A tariff does not mean that service is actually being provided.

99 The Conference Committee's ultimate adoption of Section 271 was based nearly exclusively upon the House evolution of that section. All versions of the House bill, from introduction, through Committee, to the substitute amendment approved on the House floor, contained the relevant requirement for the BOC to show an interconnection agreement with a competitive provider of local

> whatever agreement the competitor is operating under must be made generally available throughout the State. Any carrier in another part of the State could immediately take advantage of the "agreement" and be operational fairly quickly.[100]

The House thus deemed this would:

> creat[e the] potential for competitive alternatives to flourish rapidly throughout a State, with an absolute minimum of lengthy and contentious negotiations once an initial agreement is entered into. . . .[101]

Although Ameritech's submission falls far short of establishing compliance even for Grand Rapids, that town alone would not suffice. What might happen in Grand Rapids is not in this case probative or predictive of what can happen in Detroit, Lansing, Ann Arbor and other significant areas of commerce in the state of Michigan. While Congress plainly did not require statewide local competition, it certainly required more than the "experiment" of competition represented by Brooks Fiber's presence.

C. Predictable Harm to the InterLATA Market Is Alone Sufficient Reason to Deny the Application.

Without adequate competition established at the local exchange level, there will be no market disciplining effect on Ameritech to refrain from anticompetitive conduct in the interLATA market. Both discrimination and cross-subsidization remain serious threats to the interLATA competitive market.

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exchange service, and thus the House legislative history in this regard is authoritative.

100 See House Report No. 204, 104th Cong., 1st Sess. at 77 (1995).

101 Id.

1. Discrimination.

As described by the former FCC Chief Economist Joseph Farrell:

> The BOCs' incentives and ability to discriminate against rivals in long-distance -- to take the most prominent example of *MFJ* prohibitions -- depend on their market power in the local bottleneck. If we can open up the bottleneck and implement vigorous competition there, then BOCs will have little or no incentive to raise the costs of their long-distance partners -- and if they do so, those long-distance carriers and their customers will have other choices, so the harm to consumers will be limited. Thus, when there is enough competition in what is now the local bottleneck, it will make good sense to let the BOCs into complementary businesses such as manufacturing and long distance.[102]

While regulators will try to monitor for this type of misconduct, the anticompetitive opportunities available to Ameritech will be substantial. It need only adversely adjust any one of large numbers of access "details" and thereby seriously disrupt the interLATA market.[103]

Ameritech could also mask its behavior in ways that will be difficult to remedy.[104] This Commission need only look at Ameritech's cynical effort last year to supposedly

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[102] See Farrell, Joseph, Creating Local Competition, 49 Fed. Comm. L.J. 201, 207-08 (Nov. 1996).

[103] Ameritech's own experts have previously pointed out that a "firm expanding downstream may harm competition by raising rivals' costs, reducing the quality of services it provides to rivals, or by engaging in predatory tactics. Additionally, if the expanding firm is cost-regulated in the upstream market, competition and welfare could be harmed if that firm were able to allocate costs from downstream market activity to its upstream regulated business." See Gilbert & Panzar Aff. in CC Docket No. 97-1 at ¶ 20.

[104] See Shapiro Aff. at 7. The FCC's former Chief Economist has stated that "[t]hese problems are hard to regulate away, because the withdrawal of cooperation from rivals may be subtle, shifting, and temporary, but yet have real and permanent effects. . . ". See Farrell, Joseph, Creating Local Competition, 49 Fed. Comm. L.J. 201, 207 (Nov. 1996).

"protect" consumers from slamming -- a ruse intended to impede competitive inroads into its intraLATA toll monopoly. See Section IV.B, supra. The MPSC wisely enjoined Ameritech Michigan from this practice, but Ameritech Michigan can replicate this experience in myriad ways in the local market at tremendous ratepayer and taxpayer expense.

2. Cross-subsidization.

Contrary to Ameritech's contention (Br. at 82-83), regulation has not removed the BOC's incentive and ability to engage in anticompetitive conduct similar to that found under rate-of-return regulation. This is because price cap regulation is designed to consider explicitly underlying ILEC costs. The price cap scheme imposes reporting requirements for, and periodic agency reviews of, Ameritech's profit levels, i.e., rates of return. Thus, the reporting requirements and periodic reviews continue cost-based regulation. As such, they will induce Ameritech to misallocate costs from competitive services to the noncompetitive side.

In theory, these unwholesome incentives would not exist under a "pure" price cap regime. Under pure price caps, initial rates would be based on "true economic cost" and would not thereafter be altered in response to reported costs. The Commission has not adopted a pure price cap plan, however, given public policy goals other than the achievement of maximum efficiency.[105] Attention to Ameritech's

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105 From its inception, the FCC's price cap plan has explicitly sought to balance two competing goals: that of obtaining increased productivity and efficiency with assuring just and reasonable rates and quality services, as required under the Communications Act: "On the one hand, the benefits of increased productivity promised by the price cap program depend upon the creation of new profit

performance, measured in terms of its rate of return, ensures that over time rate levels do not become unjust or unreasonable, either in the political or legal sense. This "feedback" mechanism retains the unwholesome incentives embedded in traditional rate-of-return regulation.

The periodic adjustment of productivity factors, and the attending reliance upon an examination of ILEC costs, provides an example of the "feedback mechanism." The link between costs and rates retains the ILEC incentive to incur costs in order to avoid rate decreases or productivity factor increases.

> [P]rice-cap regulation can best be regarded as a loose form of rate-of-return regulation with a formal time lag. Price-cap regimes typically include a periodic review of performance (including the historic rate of return) and an adjustment in the formula to bring the projected rate of return in line with what regulators would regard as just and reasonable.
>
> We can imagine the regulated firm seeking to game the system by incurring excessive costs and thereby establishing a strong basis during the formal price-cap review for higher prices than otherwise. With these costs passed on to consumers (with a time lag), the firm could subsidize outside activities at the expense of its monopoly ratepayers.[106]

As shown, the improvements brought by price caps as actually implemented do

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incentives for the LECs. . . . On the other hand, any price cap plan must be consistent with the goals of the Communications Act, assuring just and reasonable rates and the continued availability of quality services." Policy and Rules Concerning Rates for Dominant Carriers, *Second Report and Order*, 5 FCC Rcd 6786, 6801 ¶ 121 (1990). While the "backstop mechanism" to which this passage refers has now been changed (sharing has been eliminated and the low end adjustment mechanism retained), as explained below, the principles continue to guide the FCC in setting price cap rules.

[106] Leland L. Johnson, Toward Competition in Cable Television 78 (1994)(citations omitted).

not include elimination of the regulated firm's incentive to shift costs.[107] Until and unless the FCC's statutory mandate is changed, its price cap regulation will promote the same incentive and ability to cross-subsidize as exists under rate-of-return regulation.

Not surprisingly, the Commission's recent revisions to its price cap rules leave intact its reliance on the examination of cost as an important determinant of rates. For example, while the Commission adopted a uniform 6.5% X-Factor with no sharing for all price cap LECs, it committed to a performance review in "about two years" so that the Commission can "make any necessary adjustments before the price cap plan leads to unreasonably high or low rates."[108] The Commission also refused to limit its discretion to make exogenous rate adjustments to ensure that rates permit recovery of historic costs.[109] Finally, to avoid regulatory confiscation, the Commission also retained the

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107 In upholding the FCC's price cap regulations, the D.C. Circuit acknowledged that "price cap regulation cannot quite live up to its promise. . . . Obviously no such formula can be perfect, so ultimately the Commission must check to see whether the cap has gotten out of line with reality. The prospect of that next overview may dampen firms' cost-cutting zeal." See National Rural Telecom Ass'n v. FCC, 988 F.2d 174, 178 (D.C. Cir. 1993).

108 See Price Cap Performance Review for Local Exchange Carriers, *Fourth Report and Order*, CC Docket No. 94-1, ¶ 166 (rel. May 21, 1997)("Price Cap Fourth Report and Order"). While the Commission emphasized that it will, to the extent possible, focus on "industry-wide performance or other generic factors, rather than adjustments that are tied to a particular price cap incumbent LEC's interstate earnings," see id. at ¶ 167, the ultimate determinant of "reasonableness" must remain a firm's costs. Until this legal requirement changes, the FCC's regulatory scheme will remain essentially the same.

109 See Price Cap Fourth Report and Order at ¶ 175 (noting that exogenous adjustments may be necessary to permit LECs to recover "embedded" costs).

low-end adjustment mechanism that ensures that no price cap LEC will earn less than a 10.25% interstate rate-of-return.[110]

To a greater degree, Michigan's regulatory framework creates cross-subsidy incentives and opportunities. The Michigan statute permits Ameritech to raise its local rates on the basis of increased costs, thereby encouraging Ameritech to inflate its cost accounts.[111] Further, by allowing rate increases to be justified with expenditures which most likely include common costs, the Michigan statute continues the well-established opportunities for undetected common cost misallocation.

Finally, the FCC's structural and accounting safeguards do not eliminate the opportunity to act on the incentives created by rate regulation. The Commission explicitly acknowledged in its Non-Accounting Safeguards Order that its rules leave BOCs with opportunities to misallocate the costs of their Section 272 affiliates.[112] Far

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[110] See id. at ¶ 157.

[111] Section 304(2)(c) of the Michigan Telecommunications Act permits Ameritech to file for a basic local exchange rate increase above the presumptively reasonable increase - an increase that does not exceed 1% less than the annual average percentage increase in the Detroit consumer price index. The MPSC, when reviewing the rate increase proposal, is permitted to consider "[w]hether there has been an increase in the costs to provide basic local exchange service in the geographic area of the proposed rate," Michigan Telecommunications Act, Section 304(7)(d), and "[w]hether the provider's further investment in the network infrastructure of the geographic area of the proposed rate is economically justifiable without the proposed rate." Id. at Section 304(7)(e). Further, under Michigan's rate restructuring program, Ameritech is permitted to restructure its charges "designed to recover the costs associated with the local exchange network." Id. at Section 304a(3)(b). By linking costs and local rate levels, these provisions continue Ameritech's incentives to misallocate common costs and inflate the apparent costs of the local network.

[112] In establishing the structural safeguards applicable to BOC Section 272

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112 In establishing the structural safeguards applicable to BOC Section 272

from requiring complete separation of BOCs and their Section 272 affiliates, the Commission permitted substantial integration. For example, the Commission permitted sharing of marketing and administrative services and the offices and equipment associated with those activities.[113] The Commission also permitted the operating company and its Section 272 affiliate to obtain services from the same outside suppliers.[114] Undetected cross-subsidy is therefore a recognized risk despite regulatory safeguards.

3. Access Charge Reform Is A Prerequisite to Entry.

Additionally, interLATA entry cannot be authorized until access reform is fully implemented. Competition cannot produce the hoped for efficiency gains for

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affiliates, the Commission balanced the inefficient incentives with the increased economies of scale and scope created by the integration of BOCs and their affiliates. As the Commission explained,

> [w]e believe it is consistent with both the letter and purposes of section 272 to strike an appropriate balance between allowing the BOCs to achieve efficiencies within their corporate structures and protecting ratepayers against improper cost allocation and competitors against discrimination.

Non-Accounting Safeguards Order, 5 Comm. Reg. (P&F) 750, ¶ 167. See id. at 750, ¶ 168 ("[W]e believe the economic benefits to consumers from allowing a BOC and its section 272 affiliate to derive the economies of scale and scope inherent in the integration of some services outweigh any potential for competitive harm created thereby. Therefore we permit the sharing of administrative services and other services.").

113 See id. at 752, ¶ 178. In doing so, the Commission stated that "[w]e recognize that allowing the sharing of in-house services will require a BOC to allocate costs of such services between the operating company and its section 272 affiliate and provide opportunities for improper cost allocation." Id. at 753, ¶ 180.

114 See id. at 754, ¶ 184.

consumers if regulation continues to distort the market. In its recent Access Charge Order, the Commission did remove some of the inefficiencies in the interstate access rate structure. But while it has acknowledged that current access charge levels greatly exceed costs,[115] the Commission's "market-based" approach to lowering access charges is critically dependent on competition in access that is yet to develop.[116]

The inflated access charges that Sprint and other IXCs must pay over to Ameritech and to other BOCs create indisputable problems if the latter are allowed to compete for interLATA business. Ameritech has a clear, artificial cost advantage in obtaining the access services essential to the provision of interLATA services.

Ameritech will be able to compete for additional toll calling by imputing the true cost of access; everyone else will be forced to the competitive disadvantage of including the inflated access costs charged by Ameritech. This advantage is by no means rectified by regulatory requirements of separate subsidiaries and imputation, since economic judgments will be made for the enterprise as a whole. And, of course, this artificial advantage multiplies by two for calls that both originate and terminate within the Ameritech region.[117]

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115 See Access Charge Reform, *First Report and Order*, CC Docket No. 96-262, ¶ 29 (rel. May 16, 1997)(describing effects of overallocation of intrastate costs to the interstate rate base).

116 See id. at ¶ 263. In addition, the FCC has not even established specific rules for its market-based approach.

117 In the Access Charge Order, the Commission recently concluded that price squeezes imposed by vertically integrated LECs on their long distance competitors were unlikely. See Access Charge Order at ¶ 278. In reaching this conclusion the Commission assumed that, if a LEC attempted such a price

The opportunities for Ameritech to discriminate and cross-subsidize hurts not only competitors, but consumers who otherwise reap the benefits of the competitive process. Local ratepayers are forced to subsidize the competitive ventures of the BOCs. Even if Ameritech's rates do not increase, the competition that would have driven costs (and, in the end, prices) down is absent. Second, consumers of competitive interLATA services are saddled with less efficient products and services because the market share of more efficient firms has been displaced by Ameritech -- not by better service but by misconduct.

D. Ameritech's Purported Public Interest Benefits Are Simply Conclusory Allegations Entitled To No Weight.

Ameritech argues that its entry into the long distance market would be beneficial to consumers because, it asserts, the interLATA market is not performing competitively. Ameritech relies upon a study (and subsequent book) conducted by dean Paul MacAvoy for this most counterintuitive proposition. Because no analysis can fare better than the facts upon which it is based, Ameritech's arguments are worthless.[118]

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squeeze, an IXC could bypass the LEC network by purchasing UNEs. See id. at ¶ 280. But as explained above, numerous problems remain with the provision of UNEs in Michigan. An important condition upon which the Commission relied for its conclusion in the Access Charge Order is therefore absent in Michigan.

118 It is worth noting in this regard that Ameritech's predictions of gaining market share in the in-region interLATA market are based upon the assumption that Sprint's market share will drop to one percent. See MacAvoy Aff., Table 13. While market share gains inevitably result in some other firm's loss, it is apparently Ameritech's intention to "lose" Sprint in its entirety in the state of Michigan. The public interest aspects of utterly displacing a significant, efficient and innovative competitor are not at all obvious.